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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, JANUARY 15, 2003

APPLICATION OF

VIRGINIA GAS PIPELINE COMPANY

CASE NO. PUE-2001-00359

For an Annual
Informational Filing

ORDER ADOPTING RECOMMENDATIONS
AND DISMISSING PROCEEDING

On January 22, 2002, Virginia Gas Pipeline Company ("VGPC" or the "Company"), by counsel, filed a motion with the State Corporation Commission ("Commission") to request additional time in which to file its Annual Informational Filing ("AIF") containing financial and operating data for 2001. In its motion, VGPC noted that the Commission has previously granted the Company an extension for its AIF in the Commission's July 12, 2001, Order entered herein. The Company asserted that it required a further extension beyond February 27, 2002, to May 31, 2002, to gather the appropriate information for filing its AIF.

On January 28, 2002, the Commission entered an Order wherein, among other things, it granted VGPC's request for an extension of time, and directed the Commission to file its 2001 AIF using the test period January 1, 2001, through September 2001, for all of its AIF Schedules, with the exception of

Schedules 9, 10, and 12, by no later than May 31, 2002. As to Schedules 9, 10, and 12, the Commission directed the Company to file these Schedules using the twelve months ending September 30, 2001, as the test year for these Schedules.

On June 5, 2002, VGPC delivered its AIF for the year 2001. On June 7, 2002, VGPC, by counsel, filed a motion requesting that its filing be received out of time. To support its request, the Company alleged that it was unable to file its 2001 AIF on May 31, 2002, because of extenuating family circumstances experienced by its regulatory compliance officer.

On June 14, 2002, the Commission issued its Order and granted VGPC's request to receive the Company's AIF out of time subject to a further determination concerning the completeness of the documents accompanying the AIF, and subject further to VGPC completing Schedules 9, 10, and 12, by providing data for the twelve months ending September 30, 2001.

The Company's application was determined to be complete on July 17, 2002. This application included financial and operating data for the twelve months ended September 30, 2001, for Schedules 9, 10, and 12. The remaining Schedules were provided for the nine months ended September 30, 2001.

On December 11, 2002, the Staff filed its Report on the captioned application. Staff noted in its Report that it employed a 13.5% return on equity for illustrative purposes

only. It explained that in VGPC's application for certificates of public convenience and necessity for the Company's storage and pipeline facilities, the Company assumed a cost of equity of 13.5%.

The Staff used the consolidated capital structure of NUI Corporation ("NUI") in its Report because NUI is the ultimate source of market capital available to VGPC. Prior to NUI's acquisition of Virginia Gas Company ("VGC"), VGPC's parent, and VGPC, VGC was the entity whose capital structure Staff used for ratemaking purposes. After NUI's acquisition of VGC and VGPC, NUI became the entity that accessed capital markets to supply capital to VGPC. Consistent with the change in ownership and Staff's general position regarding capital structures, Staff used NUI's consolidated capital structure for purposes of its Report. This capital structure has an equity ratio of 38.59% and produces a cost of capital of 7.69% for the test year.

Staff reported that NUI's capital structure was not significantly different from the consolidated VGC capital structure, which has an equity ratio of 36.88% and produces an overall cost of capital of 7.58%. Staff requested that, in its next AIF, the Company file Schedules 1, 2, and 3, required by the Rules Governing Utility Rate Increase Applications and Annual Informational Filings, 20 VAC 5-200-30 et seq., adopted in Case No. PUE-1999-00054 ("Rate Case Rules"), by including

information for the test year and the four prior fiscal years for VGPC and NUI.

In its accounting analysis, the Staff noted that it had reached an agreement that had been accepted by the Commission in Case No. PUE-1998-00627 regarding the treatment of capitalized interest. Based on Staff's analysis of the Company's earnings for the test year, the Company had not recovered its interest costs. Staff used the agreed upon methodology from Case No. PUE-1998-00627 to calculate a jurisdictional amount of capitalized interest to be removed from rate base. In its adjustment, VGPC removed \$647,471 of cumulative jurisdictional capitalized interest from rate base, using the agreed upon methodology versus Staff's adjustment of \$647,605. According to Staff, the difference between the Company's and Staff's adjustments was created by VGPC's use of incorrect plant and construction work in progress allocation factors.

Staff also commented that the agreed upon treatment regarding capitalized interest is an exception to the Commission's long standing approach regarding capitalized interest. Staff acknowledged that there may come a time when it may no longer be appropriate to capitalize VGPC's interest. It observed that inclusion of capitalized interest in VGPC's rates should continue to be scrutinized in VGPC's next AIF or rate case, and that the Company should reflect capitalized interest

at a level consistent with the use of the agreed upon methodology in its future filings.

As to the Company's earnings test, the Staff noted that VGPC is not earning above the 13.50% return on equity benchmark that Staff has used in prior AIFs. Additionally, Staff did not recommend any write-off of the Company's regulatory assets related to Segment 5 of the Company's P-25 Pipeline.

Further, Staff noted that on September 6, 2002, the Commission issued an Order Granting Approval in Case No. PUA-2001-00041 dealing with approval of a comprehensive affiliate agreement among VGPC, VGC, Virginia Gas Storage Company ("VGSC") and Virginia Gas Distribution Company. Since the Order Granting Approval was issued at the end of the Company's pro forma year, Staff did not make any adjustments to cost of service for the expenses related to the approval of the agreement. Staff recommended that in the Company's next AIF for the test year ended September 30, 2002, the Company should reflect adjustments to VGPC's cost of service and rate base that incorporate the distribution of costs specified in the September 6, 2002, Order.

Staff's Report also noted that on August 30, 2002, VGPC, Saltville Gas Storage Company, L.L.C., NUI Saltville Storage, Inc., and VGC filed an application with the Commission pursuant to Chapters 4 and 5 of Title 56 of the Code of Virginia. This application requested authority for the companies to transfer

and receive certain assets from both regulated and non-regulated affiliated entities of VGPC and for a reduction in service territory.

On November 22, 2002, the Commission issued its Order Granting Authority in the application docketed as Case No. PUE-2002-00458. The Commission instructed the Staff to address the transfer process for the subject real property and assets in the Company's next rate proceeding. Staff noted its intent to address these issues in the first AIF or rate case following the transfer of the assets and recommended that VGPC include with its next AIF or rate application all journal entries made to reflect the transfer of assets and real property, as well as the justification supporting the transfer price of the assets transferred in that case.

Finally, Staff also recommended that the Company capitalize property taxes on amounts relating to its property under construction.

In a letter filed with the Commission on January 7, 2003, the Company, by counsel, advised that VGPC did not intend to file a response to the December 11, 2002, Staff Report.

NOW UPON CONSIDERATION of VGPC's application, the Staff Report, and the applicable statutes, the Commission is of the opinion and finds that the Staff's recommendations found in the December 11, 2002, Report should be adopted, and this

application should be dismissed from the Commission's docket of active proceedings.

Accordingly, IT IS ORDERED THAT:

(1) Consistent with the findings made herein, the recommendations set out in the Staff's December 11, 2002, Report are hereby adopted.

(2) VGPC shall file Schedules 1, 2, and 3, in any future AIF consistent with the Commission's Rate Case Rules by including information for the test year and the four prior fiscal years.

(3) VGPC shall reflect adjustments to cost of service and rate base in its subsequent AIFs or its next rate application that incorporate the distribution of costs specified in the Commission's September 6, 2002, Order Granting Approval, entered in Case No. PUA-2001-00041.

(4) Consistent with the Staff's recommendation, the Company shall include with its next AIF or rate application all journal entries made to reflect the transfer of assets and real property addressed in Case No. PUE-2002-00458, together with the justification of the transfer price.

(5) The Company shall reflect capitalized interest at a level that is consistent with the use of the agreed upon methodology for capitalized interest reached in Case No. PUE-1998-00627 in future AIFs.

(6) VGPC shall capitalize property taxes on amounts relating to property under construction, consistent with the recommendations in the accounting analysis in the December 11, 2002, Staff Report.

(7) There being nothing further to be done in this proceeding, this application shall be dismissed from the Commission's docket of active proceedings and the papers filed herein placed in the Commission's files for ended causes.